

<b>Meeting:</b>	<b>Cabinet member contracts and assets</b>
<b>Meeting date:</b>	<b>Friday, 27 July 2018</b>
<b>Title of report:</b>	<b>Shell Store incubation centre project revision</b>
<b>Report by:</b>	<b>Economic development officer</b>

## **Classification**

Open

## **Decision type**

Key

This is a key decision because it is likely to result in the council incurring expenditure which is, or the making of savings which are, significant having regard to the council's budget for the service or function concerned. A threshold of £500,000 is regarded as significant.

This is a key decision because it is likely to be significant having regard to: the strategic nature of the decision; and / or whether the outcome will have an impact, for better or worse, on the amenity of the community or quality of service provided by the authority to a significant number of people living or working in the locality (two or more wards) affected.

Notice has been served in accordance with Part 3, Section 9 (Publicity in Connection with Key Decisions) of the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012.

## **Wards affected**

Dinedor Hill;

## **Purpose and summary**

To seek approval for the revised finances and business case for the "Shell Store" project: an extensive refurbishment and conversion of the redundant Shell Store building within the Hereford enterprise zone, to create a business incubation and research facility that will support business growth and job creation. Additional approval to let a contract for the construction of the centre is also sought.

The key revisions to the project include:

- To increase the project budget by £818,000 to a total of £7.316m;

- The increased budget reflects the high construction inflation experienced since the previous approval and an increase in the contingency to a more appropriate sum;
- The project has been delayed due to the time required to secure the external funding package, specifically securing ERDF and LEP funding.

## Recommendation(s)

That:

- (a) the revised finances and business case for the “Shell Store” business incubation centre is approved with the budget increased by £818,000 to a total of £7.316m; and**
- (b) the director for economy, communities and corporate is delegated authority to award the construction contract(s) for the centre, up to the approved budget via an appropriate procurement process or the council’s development partner.**

## Alternative options

1. Not increasing the budget would mean not proceeding with the development, as it is not possible to only refurbish/redevelop part of the building or reduce the costs further.

### *Advantages*

This option would mean that the council would not have to utilise its approved self-financing borrowing capability; the council would not be exposed to the risks associated with this project.

### *Disadvantages*

This option would result in a continuing lack of start-up space available to rent within the Hereford enterprise zone (EZ), and wider Hereford city, and an identified need and demand not being met.

The full potential of the EZ would not be realised in terms of built floor space and jobs created.

Should the council not proceed with the development but market the site for sale as commercial land it is unlikely to receive a positive value given the considerable demolition and reinstatement costs. A decaying redundant building, with local heritage significance would therefore remain an eyesore and issue to the EZ’s prime high-tech investment site. This could impact upon ability to attract high quality new businesses, land sale receipts and there could be ongoing costs to secure the Shell Store site and remove hazards.

2. Sourcing additional external funding for the project or identifying a private sector development partner to provide finance, expertise and to share the development, delivery and financial risk.

### *Advantages*

Additional external funding would reduce the council’s reliance on its borrowing capability and would reduce the risks associated with servicing borrowing.

Additionally, an experienced development partner would bring a commercial approach, expertise and would share some of the financial risk.

### Disadvantages

No other viable external funding, in addition to the £2m ERDF contribution and the £2.494m LEP interest free loan, that has already been secured, have been identified.

The development market has been tested and there is no interest amongst private sector developers to become involved in the redevelopment of a historical building, particularly given the relatively small floorspace and intention to let on short term flexible leases, which would be limited to certain specific sectors targeted by the EZ. In addition, a private sector investor would require a profit margin and that would increase total project costs.

3. There are two main procurement options for the project. This includes an open EU Tender process, to seek a new construction partner for the project only. The other option is to use the skills and experience of the council's non-residential development partner Engie. The director for economy, communities and corporate will make a decision on the procurement route taken with reference to an assessment provided by relevant officers.

### Key considerations

4. On 9 August 2017, the cabinet member corporate strategy and budget approved the refurbishment and conversion of the redundant "Shell Store" building at a cost of no more than £6.498m. Since that approval there have been changes to the costs and financing and approval is sought for these revisions. There have been no changes to the aims or the scope of this project however the details of the rationale and benefits are set out again below:
5. This project will provide employment space for up to 30 businesses when the centre is fully occupied. By 2023 it is forecast that 40 businesses will either be located in the incubator or have graduated from the centre.
6. These 30 businesses are expected to have generated circa 128 new jobs by 2023 and circa 466 new jobs by 2031. Due to the sectoral focus of the centre and the anticipated collaboration with higher education establishments 112 of these 128 jobs will require an NVQ (or equivalent) level 4 or higher. These jobs would contribute an additional £7.6m a year of gross value added (GVA) to the Herefordshire economy.
7. The Department for Business, Environment and Industrial Strategy released a report in mid-April 2017 titled – "Business Incubators and Accelerators: The national picture." This research identified that four LEPs: Cumbria, Gloucestershire, Tees Valley and The Marches – do not have business incubation or acceleration centres which reflects poorly on our wider innovation and business support.
8. Conversely the report identifies that there are five incubators in Worcestershire and that Worcestershire is in the top three LEP's in terms of highest proportion of incubators per 1,000 new businesses formed each year. The report goes on to state that UK businesses are prepared to relocate an average of 35 miles to participate in an incubator. There is therefore a prospect of Herefordshire losing good quality start-ups to incubation centres within Worcestershire.
9. Of the 205 incubator programmes in the reports data base, 111 of them have been created since the beginning of 2012 which demonstrates that incubators are a growing concept and Herefordshire is in danger of being left behind in terms of this business support provision.

10. The intention for the Shell Store project is that the facility consists of two linked components jointly referred to as the incubation centre or Shell Store:
  - a. An incubation centre providing high quality accommodation, incubation and support services to new or young enterprises.
  - b. A development and access centre managed by a Higher Education establishment which would provide a central, shared clean laboratory, research facilities and training/conferencing space that would foster and develop higher education and technology business collaborations as well as being a source of higher education and graduate enterprise in its own right.
11. There is no similar facility existing within the county. Limited incubation facilities exist within the Wolverhampton University Business Solutions Centre but cater primarily for individuals looking for desk space, there is no facility to accommodate company employee growth.
12. The Shell Store building is currently a derelict First World War construction located within the Skylon North plot on the EZ. The building has local architectural and historical value but is not listed. The refurbishment proposals would retain and refurbish the building structure to a point where new incubation and research facilities could be contained within the existing building footprint. Landscaping and car parking facilities would also be provided. The redevelopment would create approximately 2,137 sqm of employment space split between incubation space, development and access space, reception, facilities and servicing space.
13. The council has secured a £2m grant contribution towards the project from the Marches European Structural and Investment Funds (ESIF) allocation in Q1 2018 and a zero interest loan from the Marches LEP "Marches Investment Fund" of £2.494m was also agreed at the end of Q1 2018. The LEP funding agreement has been agreed in principle and will be signed very shortly. The previous decision outlined how the council were required to fund the remaining cost from prudential borrowing, to be repaid from the centre's income.
14. During the two years that the funding package took to assemble, the construction market has evolved considerably. Significant investment from both public and private sector bodies put a strain on the entire supply chain. As such, a rise on both the measured work elements and main contractor management, operating and profits costs have become evident.
15. A review of inflation based on the latest BCIS industry data indicates that the 2016 estimate should be uplifted by 14-17% in order to align with the revised delivery programme, which assumes a mid-point of construction of Q2 2019. In summary, this simple uplift would add £1.1m to the total of the previous estimate.
16. Following a process of value engineering and cost review, the revised project estimate now stands at £7.316m. It should be noted that this includes an increase in the contingency budget to an industry appropriate 5%. To implement the project the council would need to increase prudential borrowing by £822,199 to a total of £2,822,199 which will be repaid over 25 years from the centre's operating income.
17. Once built and operational the council will contract with a management body to manage the letting and marketing of the incubation facility, this will be on market terms, follow a

compliant procurement process, and will be funded through the rental income generated by the leasing of units within the building.

18. The NMiTE Higher Education project have been in discussion with the council with view to them occupying the development and access centre element of the building. This occupation will be via a lease agreement on commercial terms and NMiTE will be pay the market rate for the space.
19. In order to comply with ERDF regulations the council will retain the freehold of the building for at least a fifteen year period post completion. An EU (OJEU) compliant procurement process is required due to the value of the contract award and ERDF funding. Officers will seek procurement and legal advice from partners on the preferred procurement options including the options to use the council's development partner.

## **Community impact**

20. The site is allocated for employment use and is located within the EZ. The development will be covered by the local development order for the EZ which permits development of premises under B1, B2 and B8 use classes, subject to compliance with specified conditions including the Skylon Park design guide. The project provides space for new and growing businesses to occupy, generating new job opportunities for the local community.
21. Failure to proceed with the development will mean the loss of employment space and new job opportunities. Refurbishment and renovation into the proposed use will provide an economically viable purpose consequently protecting a building which is subject to a degree of local historical interest and is in gradual decay.
22. The Shell Store Incubation Centre contributes to the council's corporate plan priority of 'Support the growth of our economy'. It is also a priority project within the Herefordshire Economic Vision and it could significantly support the goals of the scheme including growing the local economy and creating higher value jobs. The project will also support the goals for the Marches Strategic Economic Plan including Supporting Business and Physical Infrastructure.
23. The council is committed to providing a healthy and safe environment for all individuals impacted by the council's funded activities. The council endeavours to ensure that the work they and their partners undertake, does not adversely affect the health, safety or welfare of members of the public, its staff or contractors. Therefore council partners are expected to work to the same health and safety standards and codes of practice as the council, as far as is reasonably practicable. This requirement will be included in the final contract terms

## **Equality duty**

24. Under section 149 of the Equality Act 2010, the 'general duty' on public authorities is set out as follows:

A public authority must, in the exercise of its functions, have due regard to the need to -

- a. eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;

- b. advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
  - c. foster good relations between persons who share a relevant protected characteristic and persons who do not share it.
25. The public sector equality duty (specific duty) requires us to consider how we can positively contribute to the advancement of equality and good relations, and demonstrate that we are paying 'due regard' in our decision making in the design of policies and in the delivery of services. Our providers will be made aware of their contractual requirements in regards to equality legislation.

## Resource implications

26. The financial package can be summarised as follows:

<b>Source of funding:</b>	Proposed New Budget	Difference	Previous Approved Budget
European Regional Development Fund (ERDF)	£2,000,000	£0	£2,000,000
Marches LEP loan (0%)	£2,493,801	(£4,199)	£2,498,000
Herefordshire Council prudential borrowing	£2,822,199	£822,199	£2,000,000
<b>Total Funding</b>	<b>£7,316,000</b>	<b>£818,000</b>	<b>£6,498,000</b>

	<b>Capital programme approvals (July 2018):</b>		<b>Capital programme approvals (July 2017):</b>
Specific Shell Store Budget	£7,316,000		£6,498,000

27. A contribution of £2m from the Marches ERDF programme has been secured and the funding agreement was sealed in Q1 2018 and remains unchanged from the previous approval.
28. The council have secured a £2.494m interest free loan from the Marches LEP. The contract is being finalised and it is on track to be signed/sealed by the end of July 2018. The procurement or other significant project activity will not take place until this agreement has been signed/sealed. The loan is offered on a 0% interest basis with equal principle repayments being made back to the LEP over 25 years starting one year from the opening of the centre. The final repayment date is calculated as 2045. This is broadly consistent with the amount in the previous approval.

29. The final element of the funding package proposed is £2,822,199 prudential borrowing by the council, this requirement has increased by £822,199 over the previous approval. This will be repaid by the service area over a 25 year period through net rental income generated by the project and business rates arising. The business case in Appendix B has been amended to reflect the increased costs and increased revenue that have been identify. Following this exercise, the projections outline a modest surplus of £12,552. The table summarises the average annual revenue implications over the 25 year period:

Rental and other income	£500,838
Operating costs	(£216,590)
LEP principal repayments	(£100,000)
Council borrowing costs (principal & interest – amortised)	(£171,696)
<b>surplus or (loss)</b>	<b>£12,552</b>

30. Independent advice has been taken with regard to the occupancy and rental levels that can be achieved within the completed building. This advice demonstrates that there is the ability within the project income to cover the repayments of both the LEP loan and council borrowing if both are taken out over a 25 year period.
31. Due to the operation of ERDF funding the council will be unable to dispose of the building for a period of 15 years from project completion without incurring clawback of some, or all of the ERDF grant funding (initiated on a sliding scale depending on the point of sale within the 15 years).
32. The job creation and wider economic benefits accruing from the investment have been explained and quantified above. The project will report to the EZ Capital Works Programme Board on a monthly basis that will monitor the project, spend, issues/risks and the programme. The project will also utilise the council's project management and capital monitoring systems. These, combined with the proposal in this report to increase the contingency, will aim to ensure costs remain within the budget approved and the benefits are delivered.

## Legal implications

33. The council has powers to bring forward a new site for business use, under s1 Localism Act 2011 and other legislation. The council will need to ensure that it complies with the conditions of any grant funding in the delivery of the project and will let the construction contract through an EU-procurement compliant route. The council will need to robustly manage the construction contract to demonstrate it is discharging its duty to obtain best value.
34. End users' occupation of the new site will be on commercial terms or otherwise on terms which recognises their status as start-up businesses and is compatible with the State Aid regime. The council will protect its property interests by granting tenancies or licences which are prepared with the benefit of legal advice.

## Risk management

35. The key risks around the shell store project are:

Risk / opportunity	Mitigation
Costs of the project exceed the budget	Robust, detailed and market tested cost plan that includes inflation for time of construction has been produced. A fixed price design and build contract will be let and this will transfer risk to the contractor. Any risks, will be reported to the SRO along with an analysis of impact and a recommendation.
Changes in the market conditions impact the business case	Most development schemes have an element of risk and reward in both the commissioning of work and the provision for end users. At the outset, cost planning with market testing has been undertaken, the sensitivities of the market will be monitored and reported to the project board if there is an issue. Appropriate contingency has been added to costs (including operating costs) and income has been modelled to enable flexi.
Construction/technical risks are experienced.	There is a separate risk log for all construction risks with an appropriate response. All major risks have been assessed and work has been undertaken to quantify. Appropriate contingency has now been added to the project.
Reputational risk to the council if members, businesses and the public's expectations regarding a prudent, expeditious and appropriate delivery of the scheme are not met.	The project board will oversee defined packages of work, manage risks and make decisions at the start and end of every phase. Communication to key stakeholders will be managed with support from the communications manager.
Other opportunities in the area lead to changes to the scheme which impact the business case	Any changes to the scheme will be considered on the merits of their own business case.

## Consultees



36. The EZ executive board. The board have agreed to support the incubation centre project at the Shell Store location.
37. The ward member for Dinedor has indicated that he is supportive of an increase in funding as the project will undoubtedly benefit the county greatly. He also stated his concern regarding the increase which was due to the delayed project start and how this should be avoided in future. He was however grateful that the cost increase was identified before work had started.
38. Political groups have been consulted and
  - a. The Independents support this proposal subject to strict control of costs

## **Appendices**

Appendix 1 – Site Plan

Appendix 2 – Shell Store Business Case

## **Background papers**

None Identified